



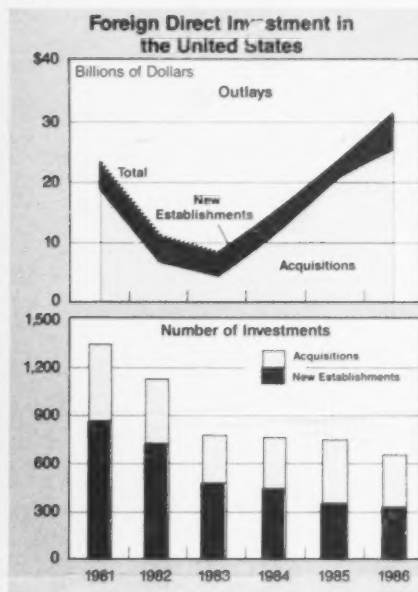
World Economic Monitor

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FOREIGN DIRECT INVESTMENT IN THE UNITED STATES

Chart 1



Foreign direct investment in the United States, lately much in the news, is not a new phenomenon. In the early days of the nation, British, Dutch, French and German investments were largely responsible for financing the infrastructure that stimulated the country's economic development.

But then, as now, such investment met with some concern that the United States might be "selling out" to foreigners. This situation prompted Alexander Hamilton, the first Secretary of the U.S. Treasury, to remark in 1791, "Instead of being viewed as a rival, [foreign investment] ought to be considered as a most valuable auxiliary, conducing to put in motion a greater quantity of productive labor, and a greater portion of useful enterprise, than could exist without it."

The task of assessing to what degree foreign investors "own" and influence the U.S. economy is complicated by the broad definition of a foreign affiliate. Generally, direct investment is a smaller share of total foreign investment here than perceived by the public. Financial investments actually are a greater burden on the U.S. balance of payments.

Between 1981 and 1986, annual outlays by foreign firms for acquisitions and construction of new facilities in this country rose by one-third; compared to 1982, a year characterized by recession, high borrowing costs, and a strong dollar, 1986 outlays had nearly tripled (Chart 1). At the same time, however, the number of new foreign investments has shrunk by about 50 percent. But this simply means that, just like in the domestic economy, individual deals have become very much larger.

The two biggest foreign acquisitions last year amounted to \$3.6 billion and \$2.0 billion, respectively; the ten largest had a combined value of \$10.2 billion. (Several British acquisitions in 1987 also have been in the \$1 billion-plus range.) Nevertheless, foreign acquisition activity in 1986 continued to be dwarfed by mergers and acquisitions among U.S. firms that were over seven times as large in value and ten times as many in number. In contrast to these fairly straightforward numbers, the role or share of foreign-owned enterprises in total U.S. business activity or in individual sectors is somewhat more difficult to pinpoint.

How Large A Presence?

What is often overlooked in the heat of discussing foreign "buying sprees" is that foreign direct investment constitutes only a small part of the recent wave of incoming foreign capital. Estimates of the book value of foreign direct investment in the United States are published regularly by the Department of Commerce. Thus, we find that between 1981 and 1986 the value of foreign-owned enterprises and other holdings (including real estate) almost doubled. But it is more complicated to relate those totals (or their annual increments) to the U.S. economy as a whole. One could say, for instance, that in 1986 the increase in foreign direct investment amounted to about 5.5 percent of U.S. expenditures on plant and equipment.

However, since foreign direct investment has occurred in virtually every

major sector of the U.S. economy, across a broad range of products and services, such a statement tells us very little about the impact on individual sectors or industries. To gauge the relative importance of the foreign presence at the sector or industry level, it would be more meaningful to use the most significant measure, such as sales or assets in most manufacturing, capacity in forest products and the iron and steel industry, construction engineering fees, and circulation in newspaper and magazine publishing. Obviously, those measures cannot be averaged or "summed across" to yield a grand total for all foreign operations in the United States.

But even at the individual industry levels there are hurdles to overcome. Since a U.S. affiliate is defined as any U.S. enterprise "in which a single foreign person owns or controls . . . 10 percent or more of the voting securities . . . or an equivalent interest," ownership patterns differ widely. It is possible to examine U.S. operations that are 100 percent foreign owned and then to calculate them as a share of a particular industry. But virtually every industry also contains numerous firms with foreign ownership of less than 100 percent. How could these be combined with wholly owned firms and included in a "measure" of foreign presence? In all such cases, the percentage of a U.S. industry's sales (or assets or capacity) accounted for by foreign affiliates would tend to overstate the participation of foreign investors in that

TABLE 1
TEN LARGEST FOREIGN INVESTMENTS
By Affiliate Sales
(End of 1986)

<i>Foreign Investor</i>	<i>Country</i>	<i>U.S. Investment</i>	<i>Percent Owned</i>
Seagram Co.	Canada	E.I. du Pont	23
		Joseph E. Seagram	100
Royal Dutch Shell	Netherlands/		
	United Kingdom	Shell Oil	100
British Petroleum	United Kingdom	Standard Oil Ohio	95
		BP North America	100
B.A.T. Industries	United Kingdom	BATUS	100
		Peoples Drug Stores	100
		Imasco USA	100
Tengelman Group	Germany	Great A&P	52
Unilever NV	Netherlands	Chesebrough-Pond's	100
		Lever Brothers	100
		Thomas J. Lipton	100
		National Starch and Chemicals	100
Nestle	Switzerland	Nestle Enterprises	100
		Carnation	100
		Alcon Laboratories	100
Mitsui & Co.	Japan	Mitsui & Co. USA	100
Petroleos de Venezuela	Venezuela	Citgo Petroleum	50
		Champlin Refining	50
Usines Renault	France	American Motors	43
		Mack Trucks	42

Source: *Forbes*

sector. Table 1, therefore, has to be interpreted with care, since the ranking is based on the 1986 sales of the U.S. affiliates, one-third of which were not wholly owned.

Perhaps the least controversial measure of the foreign presence is employment by U.S. affiliates—although even here the broad interpretation of foreign ownership tends to overstate the true shares. Overall, foreign-owned firms (excluding banks) accounted for about 2.9 percent of total U.S. nonagricultural employment in 1985 (latest year available). On the other hand, the employment share in manufacturing and in trade—which account for over half of foreign direct investment (Chart 2)—were considerably higher, at 7.5 and 3.3 percent, respectively.

There also was considerable variation within manufacturing itself. Foreign-owned affiliates accounted for 41 percent of employment in the chemical industry, for 8.7 percent in electric/electronic equipment and for 5.3 percent in nonelectrical machinery. The foreign share in the service industries, excluding wholesale trade, generally was around 3 percent or less.

In most states, foreign-owned firms likewise accounted for around 3 percent of nonagricultural employment (Table 2). In Delaware, however, "foreign" employers provided work for as much as 12 percent of the state's labor force—simply because the state's single largest employer is 23 percent foreign owned!

By a different measure, however, the U.S. affiliates of foreign companies are considerably more prominent—they are major exporters and importers. In 1985, affiliates provided 26.5 percent of total U.S. exports and took in 32.3 percent of all U.S. imports. The U.S. affiliates of Japanese companies accounted for more of U.S. trade than affiliates from any other country. In fact, the value of exports by Japanese-owned enterprises here was roughly equal to total U.S. exports to Japan in 1985; much of this trade is of course generated by the U.S. operations of the large Japanese trading houses.

Foreign-owned affiliates in the United States have consistently shown a fairly large trade deficit, and in 1985 contributed more than 40 percent of the overall U.S. deficit. This reflects the general trading pattern of foreign affiliates everywhere: They rely on their home countries, and particularly on their parent companies, for shipments of parts and components for further processing. (By contrast, U.S. trade with U.S. affiliates abroad was virtually in balance in 1985 and had shown consistent surpluses in previous years.)

To put foreign direct investment in the United States into proper perspective, it is worth noting that it has constituted only a relatively small share of the massive capital flows to this country in recent years. Although the building of new plants and the acquisition of U.S. enterprises by foreign multinationals have made headlines, foreign investors have increasingly selected from the broad range of U.S. financial instruments—from bank deposits and CDs to corporate and Treasury securities—that have long been their favorites.

Thus, while foreign direct investment accounted for 25 percent of the increase in privately owned dollar assets in 1984, it was responsible for only 14 percent of the nearly \$180 billion increase in such assets last year. Similarly, the bulk of foreigners' earnings on their dollar holdings, which will continue to be a drain on this country's external accounts for years to come, consists of interest on financial instruments. Thus, in 1986 some \$60 billion was earned by foreigners from all types of financial instruments, as against only \$5.8 billion from their direct investments in the United States.

Chart 2

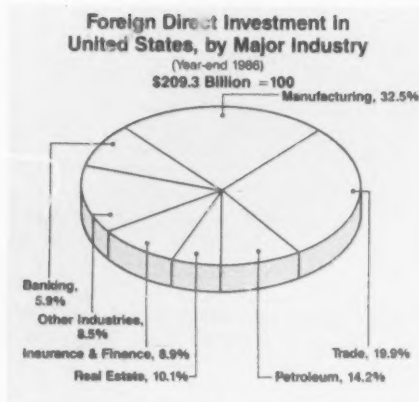


TABLE 2

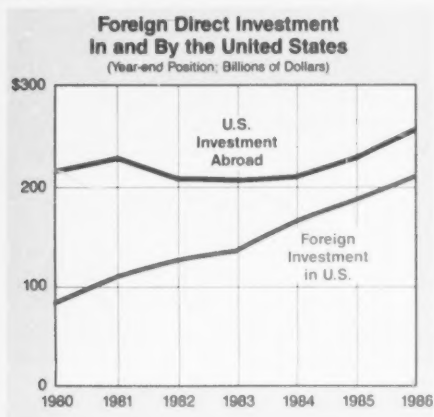
Share of Employment of Nonbank Affiliates, 1985,
By State

	Employees (in thousands)	Percent of state nonagricultural employment
California	299.3	2.7
New York	239.3	3.1
Texas	212.2	3.2
New Jersey	153.4	4.5
Pennsylvania	150.2	3.2
Illinois	144.3	3.0
Ohio	137.9	3.1
North Carolina	116.2	4.4
Georgia	107.0	4.2
Florida	95.2	2.1

Direct Investment Versus Other Capital Flows

The U.S. Direct Investment Position

Chart 3



There has been much discussion lately of the United States' having become an international debtor—according to some versions, larger than either Brazil or Mexico. Whether one subscribes to that notion or not—it would be more accurate to say that the U.S. international investment position has turned negative—the U.S. position on direct investment has remained positive (Chart 3).

True, the U.S. creditor position on that account has been shrinking. At the end of 1981, foreign direct investment in the United States totaled less than half of U.S. direct investment abroad; by end 1986, that portion had risen to close to 80 percent. It is possible, however, that the official figures tend to overstate the size of foreign direct investment in the U.S. relative to outgoing investment. This is simply because the bulk of incoming investment has taken place in recent years and thus is recorded at current prices.

U.S. direct investment abroad is of course much older—it began around the turn of the century when the United States, like today, was a net borrower from abroad. But such investment likewise is carried at book, rather than market value—much of it at prices of the 1960s and early 1970's, when the bulk of U.S. outward investment (the "American challenge") took place. Its true value, and hence the U.S. creditor position on direct investment, probably is considerably larger than the official figures show.

Investing in the United States: A Recent European View

Why are European businessmen interested in entering, operating, and investing in the U.S. market? For a European company, a presence in the United States is an important step toward competing successfully with American firms in the world market.

The American market is strategic because it offers a series of unique resources. A powerful lure is the scientific and technological environment, the existence of a "system effect" that increases the efficiency with which each company, large or small, American or not, participates in the innovation process...

A second reason for European interest in the United States is financial. The great magnitude of U.S. capital markets yield stability; large transactions do not upset the market. The U.S. market is endowed with a diversified system of financial intermediation. The presence of institutional investors, such as pension funds, gives the American market great stability and offers business a large source of risk capital to finance its investments.

A third attraction of the U.S. market is its dimension and homogeneity. The European market is large but segmented.

—Mario Schimberni, Chairman and CEO,
Montedison S.p.A., at a March 1987
conference sponsored by National
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